THE EFFECTIVENESS OF ISLAMIC FINANCE INSTRUMENTS OF THE SHARIA BANK "X" JAWA TENGAH, INDONESIA

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ABSTRACT

This study aims to evaluate the level ef effectiveness of the Islamic financial instruments at The Sharia Bank "X" Jawa Tengah, Indonesia in term of: firstly, fund utilizing management instruments of Islamic assets, secondly, the liquidity management instruments of Islamic liabilities, and thirdly, the Sharia governance framework. Implementing decriptive analysis through questionnaire distribution to the respondents with purposive sampling during October-November 2016 period, the findings show that fund utilizing management instruments of Islamic assets is moderately effective, the liquidity management instruments of Islamic liabilities is effective, and the Sharia governance framework is effective.

Keywords, Islamic assets, Islamic liabilities, Sharia governance framework

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INTRODUCTION

Islamic finance generally started as a small business in several counties, including Indonesia in the late 1980s. It distinguishes itself from conventional finance in its ostensible compliance with principles of Islamic law, or Shari'a. Islamic finance is growing fast has now widely used as financing techniques for many institutions and banks. The market appetite for Islamic finance has steadily increase specially in the Middle East region, South and South East Asia, Sahara Africa, and so forth where Muslims become predominantly inhabitants (Al Jarbi, 2004; Abdulla and Rahman, 2007; Razaq and Karim, 2008; Run and Lip, 2008).

Islamic bank has a function as a financial intermediary that sources and directs funds between sources of funds depositors, the profit rate charges in the lending activities, this difference is referred to as the spread between the cost of funds and the loan interest rate. Historically, profitability from lending activities has been cyclical and dependent on the needs and strengths of loan customers and the stage of the economic cycle, fees and financial advice constitute in more than a stable revenue for the bank which is also another sources of income for the Islamic Banks (Razaq and Karim, 2008; Run and Lip, 2008; Sole and Jobst, 2012; Harun et al., 2015).

Sources of Islamic banks funding divided into four main elements: firstly current accounts, secondly saving and deposit accounts, thirdly interbank deposits by and lastly share holders, investing these funds into productive assets and loans categories into four main categories: interbank liquidity, business and consumer finance, housing finance and long term investments (Ahmad, 1997; Arif and Safari, 2012; Sole and Jobst, 2012).

This study aims to evaluate the level ef effectiveness of the Islamic financial instruments at The Sharia Bank "X" Jawa Tengah, in term of: firstly, fund utilizing management instruments of Islamic Assets, secondly, the liquidity management instruments of Islamic Liabilities, and thirdly, the Sharia governance framework.

LITERATURE REVIEW

Ali (2013) and Harun et.al (2015) stated the elaboration on the derivatives from a conventional perspective and closest alternatives that are available in the Islamic finance. The extant literature suggests that conventional derivatives in their original form are prohibited and do not comply with Shariah regulations. Sole and Jobst (2012) and Khan and Asghar (2012) explained that Islamic financial derivatives must comply with the structure of Islamic financial law which is profit and risk-sharing criteria and regulations forbidding banks from venturing into business with high risk and extravagant uncertainty. Similarly, Arif and Safari, 2012 highlighted the operational risk in Islamic banks and institutions as it has more sophisticated key of approval elements than the conventional banks. Risk assessment instruments and hedging tools has its own engineering structure and mechanism as it has to comply with sharia and legal risk standards and methods of Islamic financial firms.

Arif and Safari, 2012 discussed on the contracts and futures contracts are permissible in conditionals. Hedgers only may take the advantage of the forward contracts in the Islamic institutions. The instruments is prohibited in terms of speculative purposes where making or taking delivery is not intentional Ali (2013) investigated the Islamic financial institution status with regard to liquidity risk and analysis of liquidity management instruments. He cocluded that many challenges Islamic financial institutions are facing due to inception and creation of instruments which have to serve the same needs as conventional products but have to be constructed in a different way. Those instruments include money market operations, which are essential for managing the bank's liquidity and cash management.

Arif and Safari (2015) illustrated that the sukuk instruments are priced significantly differently than the bonds as their assets based and not granger caused by conventional security yields or vice versa. Moreover, they described the basic contract specifications, core cash flow structures in order to develop and suggest valuation models for three selected sukuk types.

Sole and Jobst (2012) discussed the permissibility, rationale, and usage of derivative hedging instruments for market risk management in Islamic banking, essentially, an undertaking that seeks to engage in a widening and multi-layered examination as well as the exploration of new areas of relative significance. Moreover, Ali (2013) stated that the unilateral promise has been employed to structure innovative shariah compliant instruments to be used for hedging. Islam prohibits conventional forward currency contracts due to the element of riba and the violation of baya al-sarf rule. Forward currency contracts are highly needed to hedge against exchange rate volatility, these contracts have to be structured carefully so as not to contradict with shariah principles. *Harun et al (2015)* focused his study on option financial contracts, and considers the present option contracts applied is prohibited and forbidden in sharia. Majority of scholars analysis and admit that the fact of forbidding option contracts is three main facts firstly the contains of uncertainty that leads to gambling, secondly the speculation of gains, and thirdly the ignorance that expense of other parties.

RESEARCH METHOD

This study uses the descriptive method through questionnaire distribution to the respondents during October-November 2016. Implementing purposive sampling, the respondents were selected from related treasury departments of Islamic financial instrument Sharia Bank "X" Jawa Tengah. The total sample of the study is 15 respondents with 7 treasurers (46%), 5 risk assessment employees (33%) and 3 of sharia scholars (20%).

The questionnaire was developed based on extant literature containing questions that will assess each of variable with closed statements where the respondents choose one of the best answer according to their knowledge and understanding. Based on several previous studies such as Jaouadi et al. (2014) and Harun et al. (2015) this study uses the level of effectiveness for Islamic financial intrument in The Bank Sharia "X", with the criterias namely: 5= highly effective, 4= effective, 3= moderately effective, 2= ineffective, and 1= highly ineffective. Then the average answer from 25 respondents will be classified into the level of effectiveness as within range of: 1.00-1.49= highly ineffective, 1.50-2.49=

ineffective, 2.50-3.49= moderately effective, 3.5-4.49= effective, and 4.49-5.00= highly effective. Moreoever, following Jaouadi et al. (2014) and Harun et al. (2015) the level of effectiveness consist of, firstly the effectivity in fund utilizing management instruments of Islamic Assets with 5 indicators, secondly, the effectiveness in the liquidity management instruments of Islamic Liabilities with 4 indicators, and thirdly, the effectiveness in the Sharia governance framework with 5 indicators. Moreover, the indictors of fund utilizing management instruments of Islamic Assets are: preference on finance short term contract (maximum 1 year), changes leasing rate (Ijarah contract) to adjust with current economic condition, selling the project's (asset's) collateral if entrepreneur is in default, compensating loss with the profit reserve, and preference of financing entrepreneur who also has an account in The Islamic bank. Then, the indicators of the liquidity management instruments of Islamic Liabilities are: increasing revenue sharing ratio for all depositors and sacrificing bank's sharing, renegotiating revenue sharing ratio with certain depositors who have high nominal deposit, slowing the financing activities and locating more fund, and asking for a bigger bank's profit ratio in the ongoing investment project with entrepreneurs. Lastly, the indicators of the Sharia governance framework are internal Shariah review, Shariah review by external independent parties, international Shariah board member representation, continuous professional development programs for Shariah scholars, and standardization of shariah practices to facilitate harmonization.

FINDINGS AND DISCUSSION

The average answer from 15 respodents with regard to the level of effectiveness of the first variable under this study, i.e., fund utilizing management instruments of Islamic Assets is presented in table 1 as follow:

Table 1
Islamic Assets and fund utilizing management instruments

Indicators	**Average**	**Meaning**
Preference in financing short term contract (maximum 1 year)	2.61	Moderately Effective
Changes leasing rate (Ijarah contract) to adjust with current economic condition	4.00	Effective
Selling the project's (asset's) collateral if entrepreneur is in default.	4.60	Highly Effective
Compensating loss with your profit reserve.	3.00	Moderately Effective
Preference on financing entrepreneur who also has an account in your Islamic bank.	2.95	Moderately Effective
Overall Weighted Mean	3.43	Moderately Effective

Table 1 at above explains that the level of effectivity of the Islamic assets and fund utilizing management instruments has the overall mean weight of 3.43 which is moderately effective in general. Meanwhile, for each indicator, it is moderately effective in the preference in financing short term contract (maximum 1 year), effective in changes leasing rate (Ijarah contract) to adjust with current economic condition, highly effective in selling the project's (asset's) collateral if entrepreneur is in default, moderately effective in compensating loss with your profit reserve, and moderately effective in the preference on financing entrepreneur who also has an account in your Islamic bank. It means that the majority of the respondents agree with the Sharia bank decision with regard to those indicators.

Then, the average answer from 15 respodents with regard to the level of effectiveness of the second variable under this study, i.e., Islamic liabilities and liquidity management instruments is presented in table 2 bellow:

Table 2
Islamic Liabilities and Liquidity management instruments

Indicators	**Average**	**Meaning**
Increasing revenue sharing ratio for all depositors and sacrificing bank's sharing	4.65	Highly Effective
Renegotiating revenue sharing ratio with certain depositors who have high nominal deposit	4.05	Effective
Slowing the financing activities and locating more fund	4.64	Highly Effective
Asking for a bigger bank's profit ratio in the ongoing investment project with entrepreneurs	2.86	Moderately Effective
Overall Weighted Mean	4.05	Effective

Table 2 at above shows that the level of effectivity of Islamic liabilities and liquidity management has the overall mean weight of 4.05 which is effective in general. While for each indicatoer, it is highly effective in increasing revenue sharing ratio for all depositors and sacrificing bank's sharing and asking for a bigger bank's profit ratio in the ongoing investment project with entrepreneurs, effective in the renegotiating revenue sharing ratio with certain depositors who have high nominal deposit, highly effective in the slowing the financing activities and locating more fund, and moderately effective in asking for a bigger bank's profit ratio in the ongoing investment project with entrepreneurs.

Lastly, the average answer from 15 respodents with regard to the level of effectiveness of the third variable under this study, i.e., the Sharia governance framework is presented in table 3 bellow:

Table 3
Sharia governance framework

Indicators	Average	Meaning
Internal Shariah review	3.94	Effective
Shariah review by external independent parties	4.53	Highly Effective
International Shariah board member representation	2.52	Moderately Effective
Continuous professional development programs for Shariah scholars	4.62	Highly Effective
Standardization of Shariah practices to facilitate harmonization	4.58	Highly Effective
Overall Weighted Mean	4.38	Effective

Table 3 at above presents that the level of effectivity of Sharia governance framework with the overall mean weight of 4.38 which is effective in general. While for each indicator, it is effective in the internal Shariah review, highly effective in Shariah review by external independent parties, moderately effective in international Shariah board member representation, highly effective for continuous professional development programs for Shariah scholars, and highly effective for standardization of Shariah practices to facilitate harmonization.

CONCLUTIONS

This study implements purposive sampling, where the respondents were selected from related treasury departments of Islamic financial instrument The Sharia Bank “X” Jawa Tengah which ended up with 15 respondents consist of 7 treasurers, 5 risk assessment employees, and 3 of sharia scholars. Therefore, the limited number of sample becomes one of the limitation of this study.

The first finding on this study documents that the level of effectivity of the Islamic assets and fund utilizing management instruments is moderately effective. It means that the Sharia Bank “X” are able to manage Islamic assets and fund utilizing management in moderately effective level. This finding gives suggestion to the bank manaers to give more concern with regar to this aspect so that the level of effectiveness will increase into effective or highly effective in the future.

The second finding shows that the level of effectivity of Islamic liabilities and liquidity management is effective. It means that the Sharia Bank “X” are able to manage Islamic liability and liquidity in effective level. This finding represents good effectiveness level for the bank. However, it will be better if the managers can improve the level of effectiveness becomes highly effective.

The third finding presents that the level of effectivity of Sharia governance framework is effective. It means that the Sharia Bank “X” has effective Sharia governance framework. Similar with the second finding, the third finding also good. However, managers still need to improve the level of effectiveness from effective into highly effective.

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